



**OFFICE OF THE
CITY AUDITOR**

**THE WORKERS' COMPENSATION PROGRAM
MAY REQUIRE AN ADDITIONAL
APPROPRIATION OF \$5,000,000 IN 1985-86**

**A REPORT TO THE
SAN JOSE
CITY COUNCIL
SEPTEMBER 1985**



OFFICE OF THE
CITY AUDITOR

CITY OF SAN JOSÉ, CALIFORNIA

151 W. MISSION STREET, ROOM 109
SAN JOSE, CALIFORNIA 95110
(408) 277-4801

September 16, 1985
Job No. 5-48I-3

Honorable Mayor and Members
of the City Council
801 North First Street - Room 600
San Jose, CA 95110

Transmittal herewith is a report on the City's Workers' Compensation Program. This report is an extension of the June 24, 1985 memorandum I submitted to Councilmember Sausedo.

The blue page in the front of this report is an Executive Summary while the yellow page preceding the attachments is an Administration response to the report.

I will present this report to the Finance Committee at its October 1985 meeting. If you need additional information in the interim, please let me know.

Respectfully submitted,

Gerald A. Silva
City Auditor

GS:b

Attachments

cc: Gerald E. Newfarmer, City Manager
Les White, Assistant City Manager
Susan George, Deputy City Manager
Fran Galloni, Acting Director of Personnel
Dave Batton, Workers' Compensation Supervisor, OMB
Jose Garcia, Sr. Management Analyst, OMB
Ed Schilling, Director of Finance

EXECUTIVE SUMMARY

The Administration annually calculates the appropriation necessary to fund the City's self-insured Workers' Compensation Program. The Administration then factors this appropriation into City department budgets as part of Personal Services. From fiscal year 1979-80 through 1983-84 the Administration overestimated Workers' Compensation claims an average of \$943,000 per year. In order to compensate for prior year overestimations the Administration reduced projected Workers' Compensation losses by 30 percent when calculating the budget appropriation needed for Workers' Compensation in 1985-86. Our review revealed that in calculating the Workers' Compensation appropriation for 1985-86, the Administration 1) made a mathematical error which understated the appropriation necessary by \$600,000, and 2) used a methodology which arguably understated the appropriation necessary by an additional \$900,000 or a total of \$1,500,000. As a result, it is possible that an additional appropriation of \$5,000,000 in 1985-86 may be necessary in order to fully fund the City's Workers' Compensation Program given the \$1,500,000 error noted above and the \$3,500,000 shortage identified in the June 24, 1985 memorandum from the City Auditor to Councilmember Sausedo.

It is recommended that:

The Administration take into consideration the potential \$5,000,00 shortage in the Workers' Compensation Program when refined Program needs are prepared in late September 1985.

THE WORKERS' COMPENSATION PROGRAM MAY REQUIRE
AN ADDITIONAL APPROPRIATION OF \$5,000,000 IN 1985-86

The Administration annually calculates the appropriation necessary to fund the City's self-insured Workers' Compensation Program. The Administration then factors this appropriation into City department budgets as part of Personal Services. From fiscal year 1979-80 through 1983-84 the Administration overestimated Workers' Compensation claims an average of \$943,000 per year. In order to compensate for prior year overestimations the Administration reduced projected Workers' Compensation losses by 30 percent when calculating the budget appropriation needed for Workers' Compensation in 1985-86. Our review revealed that in calculating the Workers' Compensation appropriation for 1985-86, the Administration 1) made a mathematical error which understated the appropriation necessary by \$600,000, and 2) used a methodology which arguably understated the appropriation necessary by an additional \$900,000 or a total of \$1,500,000. As a result, it is possible that an additional appropriation of \$5,000,000 in 1985-86 may be necessary in order to fully fund the City's Workers' Compensation Program given the \$1,500,000 error noted above and the \$3,500,000 shortage identified in the June 24, 1985 memorandum from the City Auditor to Councilmember Sausedo.

Current Method of Estimating Workers' Compensation Claims

The Workers' Compensation Program consists of: 1) the payment of claims for state-mandated benefits for work-related injuries and illnesses to City employees, and 2) administrative costs. Our review addresses the payment of claims element in the Workers' Compensation Program.

Workers' Compensation claims are for the payment of disability compensation and/or medical costs for work related injuries or illnesses. These costs may be paid over a period of time ranging from one day to the remaining life of the injured employee. The time period is a function of the extent or nature of the injury or illness.

City policy has been to fully fund the total expected cost of Workers' Compensation claims in the year that the claims are initiated. In other words, for each claim an estimate is made of the expected costs to be paid over the life of the claim. These estimates are reviewed and updated annually. This conservative approach assures that money will be available to pay the future costs of the claims when they are due. The number and cost of the claims filed during fiscal year 1980-81 through 1983-84 are shown below:

	<u>1980-81</u>	<u>1981-82</u>	<u>1982-83</u>	<u>1983-84</u>
# of Claims	1226	1169	1305	1359
Claim Losses	\$4,511,334	\$4,084,708	\$5,735,148	\$6,694,238

To estimate the funding required for the total cost of Workers' Compensation claims for an upcoming fiscal year, a ratio of Workers' Compensation costs to Payroll costs is applied to the expected payroll cost of the upcoming year.* This ratio is developed by the State of California Workers' Compensation Insurance Rating Bureau based on Workers' Compensation claims filed throughout the State. The resultant Workers' Compensation premium is then adjusted to reflect the City's

* See ATTACHMENT I - Computation of Workers' Compensation Rates

TABLE I
ADMINISTRATION ANALYSIS OF
THE PERCENTAGE DIFFERENCE
BETWEEN PROJECTED AND
ACTUAL WORKERS' COMPENSATION
LOSSES FROM 1979-80 TO 1983-84

<u>Fiscal Year</u>	<u>Projected Losses*</u>	<u>Actual Losses*</u>	<u>Difference*</u>	<u>Percentage Projected Losses Exceeded Actual Losses</u>
1979-80	\$3.8	\$3.3	\$.5	14% (\$.5/\$3.3)
1980-81	5.1	4.5	.6	14% (\$.6/\$4.5)
1981-82	5.7	4.1	1.6	41% (\$1.6/\$4.1)
1982-83	8.3	5.7	2.6	44% (\$2.6/\$5.7)
1983-84	<u>9.1</u>	<u>6.7</u>	<u>2.4</u>	<u>36%</u> (\$2.4/\$6.7)
	\$32.0 =====	\$24.3 =====	\$7.7 =====	29.87%** =====

* Millions

** Sum of 14%, 14%, 41%, 44% and 36% divided by 5

Based upon the above analysis the Administration reduced projected Workers' Compensation losses for 1985-86 by 30 percent as shown below.

TABLE II
ADMINISTRATION REDUCTION OF PROJECTED
WORKERS' COMPENSATION LOSSES
FOR 1985-86

	<u>Payroll</u>	<u>X Rates</u>	<u>Basic Premium</u>
7706 (Fire)	25,804,619	.0879	\$2,268,226
7720 (Police)	37,249,856	.1062	3,955,935
8810 (Clerical)	32,409,182	.0054	175,010
9410 (Non Manual)	26,369,887	.0322	849,110
9420 (Manual)	26,319,368	.1183	<u>3,113,581</u>
Basic Manual Premium			\$10,361,862
Estimated Loss Ratio			<u>x.65</u>
			\$ 6,735,210
Experience Modification			<u>x1.54</u>
Projected Losses			10,372,224
--> LESS 30%*			<u>(3,111,667)</u>
Net Projected Losses			7,260,557
Interest Earnings			(1,500,000)
Subrogation Recovery			(25,000)
State Fund Reimbursement			(25,000)
Temporary Disability Adjustment**			(500,000)
Administrative Costs			<u>613,000</u>
Base Amount Required by Workers' Compensation Trust Fund for 1985-86			\$5,823,557
			=====

As shown above, by reducing projected Workers' Compensation losses by 30 percent the Administration reduced the 1985-86 appropriation requested for Workers' Compensation by approximately \$3,100,000.

It should be noted that the Administration's reduction of Projected Workers' Compensation losses by 30 percent contains the following caveat:

"...A review of the last five years indicates that the City's adopted method of projecting losses before occurrence produced an

average of 29.8% more than required per year. Therefore, we are reducing the projected losses by 30%. It should be clearly understood that it is possible this method will result in an underfunding of losses which will require additional funding in the future. (This method of projecting losses is being used temporarily pending statistical data that will be available when the Workers' Compensation computer program is operational.)..."

Identified Deficiencies In
The Administration's Methodology

In reviewing the Administration's analysis we noted two deficiencies. The first deficiency was that the Administration used the wrong figures as the denominator in calculating the percentage difference between projected and actual losses. As shown in Table I the City staff used actual losses as the denominator when in fact projected losses should be used as the denominator in calculating the degree to which the projected losses were inaccurate. Table III compares the Administration's calculated percentage difference using actual losses as the denominator versus the calculated percentage difference using projected losses as the denominator.

TABLE III

COMPARISON OF CALCULATED PERCENTAGE DIFFERENCES
USING ACTUAL LOSSES AS THE DENOMINATOR
VERSUS USING PROJECTED LOSSES AS
THE DENOMINATOR

<u>Fiscal Year</u>	<u>Projected Losses*</u>	<u>Actual Losses*</u>	<u>Differences*</u>	<u>Calculated Percentages Using as a Denominator</u>	
				<u>Actual Losses</u>	<u>Projected Losses</u>
1979-80	\$3.8	\$3.3	\$.5	14%	13%
1980-81	5.1	4.5	.6	14	12
1981-82	5.7	4.1	1.6	41	28
1982-83	8.3	5.7	2.6	44	31
1983-84	<u>9.1</u>	<u>6.7</u>	<u>2.4</u>	<u>36</u>	<u>26</u>
	\$32.0	\$24.3	\$7.7	29.8%	24.1%**
	=====	=====	=====	=====	=====

The use of the correct denominator would have resulted in an average overestimation of 24.1% instead of 29.8%. This discrepancy resulted in an underestimation of 1985-86 Workers' Compensation losses by approximately \$600,000.

The second discrepancy relates to the fact that the Administration's analysis should have compared projected losses against actual losses when calculating the percentage variance. The Administration used projected losses that were modified to reflect after-the-fact actual payroll costs. In our opinion, this does not represent an appropriate approach. Using unmodified projected losses would have further reduced the average overestimation to 15% as shown below.

* Millions

** \$7.7 divided by \$32.0 = 24.1%

CONCLUSION

The Administration reduced projected 1985-86 Workers' Compensation losses by 30 percent in an attempt to correct for historically over-estimated projections. Our review revealed two discrepancies in the Administration's methodology to refine projected Workers' Compensation losses that resulted in a \$1,500,000 underestimation of 1985-86 Workers' Compensation losses and a resultant similar under-appropriation in the 1985-86 budget. As a result, an additional appropriation of \$5,000,000 may be necessary in 1985-86 given 1) the \$3,500,000 underappropriation noted in a June 24, 1985, City Auditor memorandum and 2) the City's long standing policy of fully funding the Workers' Compensation Program.

RECOMMENDATION

It is recommended that:

The Administration take into consideration the potential \$5,000,000 shortage in the Workers' Compensation Program when refined Program needs are prepared in late September 1985.

CITY OF SAN JOSE - MEMORANDUM

TO: Gerald A. Silva
City Auditor

FROM: Susan E. George
Deputy City Manager

SUBJECT: RESPONSE TO DRAFT REPORT ON THE
WORKERS' COMPENSATION PROGRAM

DATE: September 12, 1985

APPROVED

DATE

The City Manager has asked that I respond on his behalf to your draft report on the Workers' Compensation Program. Thank you for giving us the opportunity to submit my comments for potential inclusion in the final report.

The Workers' Compensation Program has been an area of concern for this administration during the past year. Emphasis has been placed both upon improving the processes utilized for estimating annual contribution rates and upon developing and implementing an automated system for handling and reporting the hundreds of claims filed each year. Your office's review of the program has underscored the importance and urgency of proceeding with these improvements.

Your report highlights two problems with the methodology utilized to calculate the 1985-86 Workers' Compensation appropriation. The first problem concerned the application of an incorrect figure as the denominator in developing the 30% overestimation rate. As your report indicates, the projected losses should have been utilized instead of the actual losses. I fully agree with this finding and conclusion. This inappropriate application has been noted by the Workers' Compensation Administration and will be corrected in future calculations.

The second problem, as you state in your report, is that a methodology was utilized to determine the 30% overestimation rate which "arguably" understated the needed appropriation. I agree that the methodology is arguable. It appears to me that there are a number of different approaches to the development of the appropriate rate and that each should be further analyzed by staff. A number of variables were not considered in devising the methodology adopted which warrant consideration. This was clearly identified for staff as a result of your review and critique of the prevailing methodology.

The entire issue of appropriate funding levels for the Workers' Compensation Program is under current review and analysis by staff. As is recommended in your report, the potential \$5 million shortfall and the causes of it are an integral part of that work, and will be fully considered in the development of an updated report and recommendation to the City Council on the Workers' Compensation Program.

Again, thank you for the opportunity to comment.

RECEIVED
SEP 12 1985

Susan E. George
SUSAN E. GEORGE
Deputy City Manager

SEG:ao
2641m

CITY AUDITOR

CITY OF SAN JOSE - MEMORANDUM

TO: Gerald Silva
City Auditor
SUBJECT: COMPUTATION OF WORKERS' COMPENSATION
RATES

FROM: Jose Garcia
Sr. Mgmt. Analyst
DATE: July 10, 1985

APPROVED

DATE

The following information on the methodology used by the Office of Management and Budget to calculate the Workers' Compensation rates for budget purposes is provided per your request.

The development of the contributions to the Worker's Compensation Fund involves two separate computations. The first computation determines the base funding requirement for the Workers' Compensation fund. This step is the key computation that identifies the program's budget needs. The second computation is simply to determine the rates that must be applied to the payroll for the purpose of distributing the total costs (identified by the first computation) to all City programs.

The methodology for each of these two computations are described below:

COMPUTATION TO DETERMINE BASE FUNDING REQUIREMENTS

The total dollar amount contribution to the Workers' Compensation Trust Fund is based on the application of State Workers' Comp rates to City base payroll levels to determine a basic premium which the City would pay if State-insured. Since the City is self-insured, an experience modification rate is applied to the basic premium to determine the City's premium level. The experience modification rate is developed by the Workers' Compensation Division based on the State's expected losses and the City's actual losses. An estimated loss ratio is applied to the City's premium level to determine the estimated losses for the self-funded program. This step removes administrative costs, overhead, profits, dividends and contingency reserves which are included in the State's rates and produces the City's actual needs to cover losses. Additional adjustments in the form of revenue, expenditures, and surpluses related to the Workers' Comp program are applied to determine the net total funds required for the Workers' Comp Fund from other City funds. The experiences and losses rates and other adjustments are provided by the Personnel Department, and the base payroll levels are provided by OMB.

COMPUTATION TO DETERMINE COST DISTRIBUTION RATES

To determine the rates for the ABS, the State rates are adjusted by the variance between the basic premium and the total funds required from other City funds. The methodology of adjusting the State rates to determine the City's rates is used because the City is still in the process of developing a data base for projecting City rates independent of State rates. With the aid of automation, the City will be able to project independent rates in the near future.

RECEIVED
JUL 24 1985

Note that with the ABS, payroll levels change as revisions and adjustments are made to classifications, positions, and labor forecasts. Variances between the basic premium and the required funding level could be recalculated each time the payroll level changes. Since these changes often occur on a daily basis during the budget process, rate recalculations would not be practical. Thus, the adjusted rates for the ABS are determined when a fairly clean run of the base payroll is produced by the ABS. (Note that the base payroll is then manually adjusted to reflect a portion of overtime pay and other special pay such as higher class and night shift differential pay which the ABS does not recognize for Workers' Comp calculations.)

For 1983-84 and '84-85, the variance between the basic premium and the required funds was distributed evenly among the five Workers' Comp code categories. The variance was calculated as follows:

Variance Factor

$$\frac{1. \text{ Base Requirement}}{\text{Total Basic Premium}} = \text{Variance Factor}$$

$$2. \text{ Variance factor} \times \text{State Rate} = \text{ABS Rate.}$$

For 1985-86, calculation of the ABS rates was refined with the use of a computerized worksheet to prorate the variance factor by Workers' Comp code category. The variance was determined by distributing the City's adjustments and modifications based on the basic premium levels per category. This method produced a required need per category which was used to generate rates for the ABS.


The Workers' Compensation rates by category as produced by OMB for budget purposes are as follows:

CLASS	1985-86	1984-85	1983-84	1982-83
Fire	5.23%	2.37%	6.77%	N/A
Police	6.16%	2.52%	9.44%	N/A
Clerical	0.31%	0.12%	0.35%	N/A
Non-manual	1.86%	0.68%	1.86%	N/A
Manual	6.85%	2.72%	7.94%	N/A

Detailed worksheets to generate these rates are attached. If you have any questions regarding the methodology or calculations, contact Cleo Asuncion-Heppes of OMB staff or me at extension 5111.



Jose Garcia
Sr. Management Analyst


JG:CAA:jc
Attachments
cc: Ken Arimura, Auditor's Office
Fran Galloni, Personnel
Ed Overton, Personnel
Dave Batton, Personnel
3355b

WORKERS' COMPENSATION
BASE PROJECTION FOR 1985-86

*Initial
submitted*

	PAYROLL	X RATES	BASIC PREMIUM
7706 (Fire)	25,804,619	.0879	\$2,268,226
7720 (Police)	37,249,856	.1062	3,955,935
8810 (Clerical)	32,409,182	.0054	175,010
9410 (Non Manual)	26,369,887	.0322	849,110
9420 (Manual)	26,319,368	.1183	<u>3,113,581</u>

Basic Manual Premium	\$10,361,862
Estimated Loss Ratio	x.65
	<u>\$ 6,735,210</u>
Experience Modification	x1.54
Projected Losses	10,372,224
<u>Less 30%*</u>	<u>(3,111,667)</u>
Net Projected Losses	7,260,557
Interest Earnings	(1,500,000)
Subrogation Recovery	(25,000)
State Fund Reimbursement	(25,000)
Temporary Disability Adjustment**	(500,000)
Administrative Costs	<u>613,000</u>

BASE AMOUNT REQUIRED BY WORKERS'	
COMPENSATION TRUST FUND FOR 1985-86	<u>\$5,823,557</u>



* A review of the last five years indicates that the City's adopted method of projecting losses before occurrence produced an average of 29.8% more than required per year. Therefore, we are reducing the projected losses by 30%. It should be clearly understood that it is possible this method will result in an underfunding of losses which will require additional funding in the future. (This method of projecting losses is being used temporarily pending statistical data that will be available when the workers' compensation computer program is operational.)

** Temporary disability payments are included in the above payroll rates, but are paid to employees in their regular paycheck as disability leave. Therefore, the Workers' Compensation Trust Fund does not need this part of the workers' compensation premium.

9400q

3-15-85
FROM PERSONNEL DEPT.

Attachment II

Calculation of ABS/Payroll Workers' Compensation Rates

A. Calculation of 1983-84 Workers' Compensation Rates

1. 1983-84 Variance Factor

$$\frac{\text{Base requirement } \$6,539,060}{\text{Basic Premium } \$10,522,662} = .6214 \text{ (Variance factor)}$$

2. 1983-84 Base ABS Rate

<u>Code</u>	<u>Category</u>	83-84 <u>State Rate</u>		<u>Variance</u>		Base <u>ABS Rate</u>
7706	Fire	.1060	X	.6214	=	.0659
7720	Police	.1479	X	.6214	=	.0919
8810	Clerical	.0054	X	.6214	=	.0034
9410	Non-manual	.0291	X	.6214	=	.0181
9420	Manual	.1242	X	.6214	=	.0773

3. 1983-84 Base ABS Rate Generation

Code		Category	83-84 ABS Rate	83-84 Base Payroll	Base Contribution
7706	Fire	.0659	X	\$22,279,077	= \$1,468,000
7720	Police	.0919	X	31,181,210	= 2,866,000
8810	Clerical	.0034	X	24,655,036	= 84,000
9410	Non-manual	.0181	X	21,215,675	= 384,000
9420	Manual	.0773	X	22,535,158	= 1,742,000
Total Base contribution to the Workers' Comp Fund					\$6,544,000

ATTACHMENT II (con't.)

4. Recalculation of 1983-84 Base Requirement

The following recalculation was completed to account for overtime and special pay.

<u>Code</u>	<u>Category</u>	<u>83-84 Adjusted Base Payroll 2)</u>		<u>State Rate</u>		
7706	Fire	22,813,000	X	.1060	=	\$2,418,178
7720	Police	31,865,210	X	.1479	=	4,712,865
8810	Clerical	24,735,036	X	.0054	=	133,580
9410	Non-manual	21,219,675	X	.0291	=	617,492
9420	Manual	23,435,158	X	.1242	=	<u>2,910,647</u>
						\$10,792,762
Experience Modification						X 1.30
						<u>14,030,590</u>
Estimated Loss Ratio						X.63
Estimated Losses						<u>8,839,272</u>
Administration Costs						540,000
Less Anticipated Interest						(1,500,000)
Subrogation Recovery/Reimb.						(10,000)
Surplus Reserves						<u>(1,148,000)</u>
Revised Base Requirement						\$6,721,272
Base Contribution						<u>(6,544,000)</u>
Net Additional Requirement						<u>177,272</u>
Percent Increase over Base Contribution						2.7%

2. Includes manual adjustment to reflect 2/3 of overtime pay plus all special pay.

5. Adjustment to 1983-84 Base ABS Rates

The following adjustment to the base ABS rates was made to account for the additional requirement for overtime and special pay.

<u>Code</u>	<u>Category</u>	<u>Base ABS Rate</u>		<u>Percent Increase</u>		<u>ABS Rate</u>
7706	Fire	.0659	X	1.027	=	.0677
7720	Police	.0919	X	1.027	=	.0944
8810	Clerical	.0034	X	1.027	=	.0350
9410	Non-manual	.0181	X	1.027	=	.0186
9420	Manual	.0773	X	1.027	=	.0794

ATTACHMENT II (Con't.)

B. Calculation of 1984-85 Rates1. Recalculation of Basic Premium

The following recalculation of the basic premium was made based on revised payroll levels:

<u>Code</u>	<u>Category</u>	<u>Revised Payroll</u>		<u>84-85 State Rates</u>		<u>84-85 Basic Premium</u>
7706	Fire	\$25,300,000	X	.1010	=	\$2,555,300
7720	Police	35,109,000	X	.1073	=	3,767,196
8810	Clerical	26,878,000	X	.0053	=	142,453
9410	Non-manual	22,757,000	X	.0285	=	648,575
9420	Manual	24,661,000	X	.1160	=	2,860,676
84-85 Revised Basic Premium						\$9,974,200

2. 1984-85 Variance Factor

Base Requirement	\$2,342,000	
	<u> </u>	= .23481
Basic Premium	\$9,974,200	

3. Calculation of '84-85 ABS Rates

<u>Code</u>	<u>Category</u>	<u>84-85 State Rate</u>		<u>Variance Factor</u>		<u>84-85 ABS Rate</u>
7706	Fire	.1010	X	.23481	=	.0237
7720	Police	.1073	X	.23481	=	.0252
8810	Clerical	.0053	X	.23481	=	.0012
9410	Non-manual	.0285	X	.23481	=	.0068
9420	Manual	.1160	X	.23481	=	.0272

C. Calculation of 1985-86 Rates

See Attachment IIa, Workers' Compensation Base 85-86 ABS Rate Projection. Note that this calculation was based on a revised payroll level plus adjustments for overtime and special pay. This calculation produced a basic premium level of \$10,821,954 and a base requirement of \$6,164,543. The ABS rates reflect the ratio of the base requirement and the base payroll since the ABS cannot recognize the overtime or special pay used to produce the adjusted payroll for this calculation.

85-86
Rate
Calculated

WORKERS' COMPENSATION BASE 85-86 ABS RATE PROJECTION

BASE AMOUNT REQUIRED BY WORKERS' COMPENSATION TRUST FUND FOR 1985-86

AS OF: 4/1/85 CRUNCH (WORKSHEET REVISED 4/5/85)

	BASE PAYROLL	'2' / OVERTIME ADJUSTMENTS	ADJUSTED PAYROLL	X STATE WC RATES	BASIC PREMIUMS	PERCENT OF TOTAL	ESTIMATED LOSS RATIO**	ADJUSTED PREMIUMS
7706 FIRE	\$25,804,619	\$1,147,168	\$26,951,787	0.0879	\$2,369,062	21.9%	0.65	\$1,539,890
7720 POLICE	\$39,370,200	\$742,784	\$40,112,984	0.1062	\$4,259,999	39.4%	0.65	\$2,768,999
8810 CLERICAL	\$32,403,853	\$535,093	\$32,938,946	0.0054	\$177,870	1.6%	0.65	\$115,616
9410 NON-MANUAL	\$26,491,779	\$432,568	\$26,924,347	0.0322	\$866,964	8.0%	0.65	\$563,527
9420 MANUAL	\$26,174,030	\$436,782	\$26,610,812	0.1183	\$3,148,059	29.1%	0.65	\$2,046,238
TOTAL	\$150,244,481	\$3,294,395	\$153,538,876		\$10,821,954	100.0%		\$7,034,270

	EXPERIENCE MODIFICATION	MODIFIED PREMIUMS	LOSSES MODIFICATION	NET PROJECTED LOSSES	NET ADJUSTED PREMIUMS
7706 FIRE	1.54	\$2,371,431	0.30	\$711,429	\$1,660,002
7720 POLICE	1.54	\$4,264,259	0.30	\$1,279,278	\$2,984,981
8810 CLERICAL	1.54	\$178,048	0.30	\$53,414	\$124,634
9410 NON-MANUAL	1.54	\$867,831	0.30	\$260,349	\$607,482
9420 MANUAL	1.54	\$3,151,207	0.30	\$945,362	\$2,205,845
TOTAL		\$10,832,776		\$3,249,833	\$7,582,943

	INTEREST EARNINGS	SUBROGATION RECOVERY	STATE REIM- BURSEMENT	TEMP. DISABIL. ADJUSTMENT	TOTAL OTHER ADJUSTMENTS*
7706 FIRE	\$328,369	\$5,473	\$5,473	\$109,456	\$448,771
7720 POLICE	\$590,466	\$9,841	\$9,841	\$196,822	\$806,970
8810 CLERICAL	\$24,654	\$411	\$411	\$8,218	\$33,694
9410 NON-MANUAL	\$120,167	\$2,003	\$2,003	\$40,056	\$164,229
9420 MANUAL	\$436,343	\$7,272	\$7,272	\$145,448	\$596,336
TOTAL	\$1,500,000	\$25,000	\$25,000	\$500,000	\$2,050,000

	ADJUSTED NET PROJECTIONS	ADMIN COSTS	BASE REQUIREMENTS	PERCENT OF REQUIREMENTS	PROJECTED 85-86 ABS RATE	PROJECTED WKR COMP BASE
7706 FIRE	\$1,211,231	\$138,265	\$1,349,496	21.9%	0.0523	\$1,349,496
7720 POLICE	\$2,178,011	\$248,626	\$2,426,636	39.4%	0.0616	\$2,426,636
8810 CLERICAL	\$90,940	\$10,381	\$101,321	1.6%	0.0031	\$101,321
9410 NON-MANUAL	\$443,253	\$50,598	\$493,851	8.0%	0.0186	\$493,851
9420 MANUAL	\$1,609,509	\$183,730	\$1,793,239	29.1%	0.0685	\$1,793,239
TOTAL	\$5,532,943	\$631,600	\$6,164,543	100.0%		\$6,164,543

	CURRENT ABS RATE	CURRENT BASE PROJECTION	DIFFERENCE CURR. VS. PROJ.
7706 FIRE	0.0237	\$611,569	\$737,927
7720 POLICE	0.0252	\$992,129	\$1,434,507
8810 CLERICAL	0.0012	\$38,885	\$62,436
9410 NON-MANUAL	0.0068	\$180,144	\$313,707
9420 MANUAL	0.0272	\$711,934	\$1,081,305
TOTAL		\$2,534,661	\$3,629,883

CITY OF SAN JOSE ---- MEMORANDUM

TO: Patricia Sausedo
Councilmember
SUBJECT: Workers' Compensation
Appropriation

FROM: Gerald A. Silva
City Auditor
DATE: June 24, 1985
Job No. 5-481-1

APPROVED:

DATE:

X 4601

In accordance with your request of May 22, 1985, the Office of the City Auditor has reviewed the \$3.2 million Workers' Compensation adjustment in the City Manager's May 20, 1985 Budget Preview Summary. Our review revealed that the reason for the adjustment was that the Administration's methodology for estimating 1984-85 Personal Services was faulty. In the future, the Administration should not estimate current year expenditures based upon prior years expenditures. Instead, the Administration should use current years actual expenditures to date and extrapolate those expenditures out for the remainder of the year.

In addition, our review revealed that the Workers' Compensation Fund is currently projected to require an additional appropriation of approximately \$3.5 million in 1985-86. Such an appropriation will be necessary if the City's policy of fully funding the Workers' Compensation Trust Fund is to be continued. The City Council may wish to consider this potential problem during its budget deliberations.

The Office of the City Auditor is currently reviewing the following two other Workers' Compensation areas:

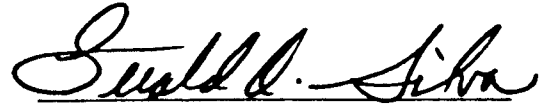
- o Current methods of calculating Workers' Compensation appropriations

* See ATTACHMENT IV

- o The historical accuracy of estimated Workers' Compensation expenditures

These reviews should be completed in July 1985.

Because of time constraints, it was not possible to allow for the City Administration to preview this memorandum. Every effort will be made to avoid this situation in the future.



Gerald A. Silva
City Auditor

GS:jm

Attachment

cc: Mayor Tom McEnery
Members of the City Council
Gerald Newfarmer
Les White
Susan George
Richard Barakatt
Dave Batton
Jose Garcia
Cleo Asumcion-Heppes

THE \$3.2 MILLION WORKERS' COMPENSATION ADJUSTMENT IN
THE CITY MANAGERS' MAY 20, 1985 BUDGET PREVIEW SUMMARY

The Administration overestimated 1984-85 General Fund Personal Services by 3.2 million in the "Source and Use of Funds" it presented to the City Council on March 28, 1985. The reason for the overestimation was that the administration's methodology for estimating 1984-85 Personal Services was faulty.

On May 20, 1985, the City Manager submitted to the City Council a Budget Preview Summary preparatory to the 1985-86 budget process. The Summary detailed the differences between the Administration's March 28, 1985 projection of \$7.5 million as being available for new programs and its May 20, 1985 projection of \$15.3 million. One of the differences the administration detailed was that it overestimated Workers' Compensation expenditures by \$3.2 million in its March 28, 1985 projection.

The City Workers' Compensation Trust Fund is a fully reserved Fund. To ensure the solvency of the Fund, claim reserves are established by reviewing all individual disability claims that remain open more than six months to determine what costs are likely to result during the life of the claim. Reserve amounts for all claims are reviewed and revised at least annually. *

When calculating the Workers' Compensation Fund budget appropriation for the next fiscal year, a reduction is made for any estimated Surplus Reserves at the end of the current year. This deduction is very germane to the \$3.2 million overestimation because the Surplus Reserve at the end of 1983-84 was a very large \$4,090,000.

* See ATTACHMENT II

The following schedule shows how the 1984-85 Workers' Compensation appropriation was calculated and the importance of the Surplus Reserve in that calculation.

SCHEDULE 1

CALCULATION OF 1984-85 WORKERS' COMPENSATION APPROPRIATION

Estimated Losses	\$8,406,696
Plus:	
Administrative Costs	<u>540,000</u>
	\$8,946,696
Less:	
Interest Earnings, State Reimbursements, Recoveries and Temporary Disability	<2,515,000>
SURPLUS RESERVES	<u><4,090,000></u>
1984-85 Appropriation	\$2,341,696 * =====

Because of the large surplus reserve at the end of 1983-84 the 1984-85 Workers' Compensation appropriation was actually \$4,436,710 less than 1983-84 expenditures(\$6,818,354-\$2,381,644). The real significance of this difference lies in the fact that the Workers' Compensation appropriation is dispersed throughout City Agency budgets as part of "Benefits" and is therefore included in Personal Services. When the Administration estimated 1984-85 Personal Services expenses for the March 28, 1985 Source and Use of Funds it multiplied 1983-84 actual

* Adjusted to \$2,381,644 - See ATTACHMENT I

Personal Services by 1.06. This methodology completely ignored the fact that 1) 1983-84 Workers Compensation expenses were already \$4,436,710 higher than 1984-85 and 2) the error was compounded by inflating the 1983-84 base by 6 percent to arrive at a 1984-85 estimate.

1983-84 Workers Compensation Expenses	\$6,818,354
1984-85 Adjustment Factor	<u>1.06</u>
1984-85 Administration Estimate at 3/28/85	\$7,227,455
1984-85 Current Administration Estimate	<u>2,480,686</u>
Overestimate of 1984-85 Workers Compensation Expenses	\$4,746,679 =====
General Fund Share (78.3 percent)	\$3,716,649 =====

As shown above, the Administration actually overestimated the General Fund share of the Workers' Compensation component in Personal Services in its March 28, 1985 projection by \$3,716,649. Other countervailing factors in the March 28, 1985, Personal Services calculation apparently mitigated the Workers' Compensation overestimate somewhat. As a result, the net effect was the \$3.2 million overestimate reported by the Administration in its May 20, 1985 communique.

In the future, the Administration should not estimate current year expenditures based upon prior years expenditures. Instead, the Administration should use current years actual expenditures to date and extrapolate those expenditures out for the remainder of the year. By so doing, the Administration would avoid problems such as the one described above.

PROJECTED \$3.5 MILLION DEFICIT IN WORKERS
COMPENSATION TRUST FUND FOR 1985-86

According to latest Administration estimates, the Workers' Compensation Trust Fund will require an additional appropriation of \$3,518,547 in 1985-86, if the City's policy of fully funding the Trust Fund is to be continued. While the current estimate is subject to change and will not be finalized until September 1985, it appears very likely an additional appropriation will be needed in the next fiscal year. The City Council may want to consider this potential appropriation requirement during its 1985-86 budget deliberations.

A March 26, 1985, memorandum from Robert A. Farnquist, Director of Personnel, to Richard A. Barakatt, Budget Supervisor * states in part:

"...City policy and procedures provide for a fully funded workers' compensation program. In order to carry out this fiscally sound policy, fiscal year losses are projected before actual occurrence. When actual claims are filed, reserves are set aside based on our estimate of future liability for each claim. These reserves are refined yearly as we receive more accurate information about claims costs..." (Emphasis added)

"...Because of the investment loss there will be a partially unfunded liability for workers' compensation claims occurring in the 1984-85 fiscal year. The exact amount of unfunded liability is unknown at this time...."(Emphasis added)

* ATTACHMENT III is a complete test of the memorandum.

The memorandum included the following estimate of the unfunded liability of the Workers' Compensation Trust Fund:

1984-85 FY Estimate

Interfund Transfer	\$2,480,686
Interest Earnings	1,500,000
Temporary Disability Adjustment	500,000
Surplus as of 6-30-84	959,767
Projected Losses	<8,407,000>
Administrative Expense	<u><552,000></u>
CURRENT ESTIMATED DEFICIT AS OF 6/30/85	<3,518,547>

The memorandum also states in part that:

"...The projected deficit is the result of the 6.3 million dollar loss charged to the Workers' Compensation Trust Fund as a result of the 60 million dollar investment loss. The deficit will be partially offset by what would have been a two million dollar surplus in claim reserves as of June 30, 1984. The unfunded liability will be further reduced if there is a favorable difference between projected losses and actual losses when evaluation of the 84-85 losses can be completed, as well as the annual re-evaluation of losses for all self-insured years, 74-75 through 83-84. This evaluation will be completed by September 1985...."

The memorandum concludes with the following recommendation:

"...It is recommended that the unfunded liability be more clearly defined (in September 1985) before additional appropriations be considered for the Workers' Compensation Trust Fund. However, if this recommendation is followed, it should be understood that a partially unfunded liability will exist

and that the revised method used to determine the recommended interfund transfer for 1985-86 is not expected to create a surplus in the Trust Fund to offset the unfunded liability or reduce the 1986-87 appropriation to the Workers' Compensation Trust Fund...." (Emphasis added)

Accordingly, it is clear that 1) there will be an unfunded liability with the Workers' Compensation Trust Fund unless an additional appropriation is made sometime during 1985-86 and 2) the exact amount of the unfunded liability cannot be determined at this time. It is also clear that because of the potential significant appropriation that may be required, the City Council should have a complete understanding of this situation before finalizing the 1985-86 budget. Should the 1984-85 deficit turn out to be \$3,518,547, then an additional General Fund appropriation of approximately \$2.9 million * will be required in 1985-86 to fully fund the Trust Fund. The significance of such an additional appropriation lies in the fact that the unrestricted General Fund surplus for 1985-86 is currently projected to be \$6.2 to \$6.3 million.

On August 18, 1981, J.P. Van Sambeck, Deputy City Manager forwarded to Robert Farnquist, Director of Personnel, revised procedures for determining annual General Fund appropriations to the Workers' Compensation Fund. ** These procedures state in part:

"...On July 1, 1974, the City implemented a self-administered workers' compensation program to provide identical benefits

* In 1985-86 the General Fund represents 83.7 percent of agency transfers to the Trust Fund. (\$3,518,547 x 83.7 percent equals \$2,945,023).

** See ATTACHMENT II for a complete text of the procedures.

at a savings to the City resulting from reduced operating costs. The Workers' Compensation Trust Fund was established by Ordinance #17284...."

"...The City of San Jose shall maintain a fully reserved Workers' Compensation Trust Fund in the same manner as the law requires of non-public agency self-insured employers and of Workers' Compensation insurance companies...." (Emphasis added)

Based upon the above stated policy, it appears that the City Council will have to appropriate a significant amount of additional funds during 1985-86, if the City's current policy of fully funding the Workers' Compensation Trust Fund is to be continued. It seems appropriate for the City Council to review the City's current policy of fully funding the Workers Compensation Trust Fund prior to finalizing the 1985-86 budget. Should the Council wish to continue the fully funding practice, then some provision should be made in the 1985-86 budget subject to final deficit figures being developed.

<u>PAYROLL CLASS</u>	<u>ESTIMATED PAYROLL</u>	<u>RATES</u>	<u>BASIC PREMIUM</u>
7706 (Fire)	\$25,605,000	x .1010 =	\$ 2,586,105
7720 (Police)	25,819,000	x .1073 =	3,843,379
8810 (Clerical)	27,067,000	x .0053 =	143,455
9410 (Non-manual)	22,662,000	x .0285 =	645,867
9420 (Manual)	24,916,000	x .1160 =	2,890,256

Basic Premium	\$10,109,062
Experience Modification	x 132%
Modified Premium	13,343,962
Estimated Loss Ratio	x .63
Estimated Losses	\$ 8,406,696
Administrative Costs	540,000
Interest Earnings	(2,000,000)
State Fund Reimbursement	(10,000)
Subrogation Recovery	(5,000)
Surplus Reserves	(4,090,000)
Temporary Disability*	(500,000)

BASE AMOUNT REQUIRED BY WORKERS'
COMPENSATION TRUST FUND FOR
1984/85

\$2,342,000

~~2,342,000~~

~~2,342,000~~

Appn = \$2,381,644

* The Workers' Compensation rates used include the cost of temporary disability payments which are made from departmental personnel costs and have then been paid to the General Fund by the Workers' Compensation Trust Fund on a quarterly basis. Beginning with 1984/85 the funds for the temporary disability payments will be deleted from the Workers' Compensation budget request and the quarterly transfer of funds from the Trust Fund to the General Fund will be eliminated.

PROCEDURE FOR DETERMINING ANNUAL GENERAL FUND APPROPRIATION

The amount resulting from these calculations becomes the base workers' compensation allocation. This calculation is demonstrated in the following example:

ESTIMATED 1981-82 WORKERS' COMPENSATION APPROPRIATION CALCULATION

	<u>Est. 81-82 W/C Payroll*</u>	<u>X Rate</u>	<u>Basic Premium</u>
7706 (Fire)	\$18,407,064	.0949 =	\$1,746,830
7720 (Police)	24,902,474	.1392 =	3,466,424
8810 (Clerical)	19,331,250	.0042 =	81,191
9410 (Non-Manual Labor)	17,763,974	.0303 =	538,248
9420 (Manual Labor)	<u>18,031,335</u>	.1100 =	<u>1,983,447</u>
	\$98,436,117		\$7,816,141
	Experience Modification		x 105%
	Estimated Premium if Insured		\$8,206,948
	Estimated Loss Ratio**		x .63
			\$5,170,377
	Plus Administrative Costs		315,000
	Less Anticipated Interest		<1,000,000>
	Less Surplus Reserves		<926,000>
	Less State Fund Reimbursement & Other		<10,000>
	Estimated Amount Needed from General Fund		<u>\$3,550,377***</u>

*Workers' Compensation payroll estimate was obtained by projecting 1980-81 Workers' Compensation payroll through June 1981 and adding estimated percentage wage increases to each Workers' Compensation payroll class (estimated increase to be determined jointly by GMS and Personnel). The actual percentage of increase (if any) projected for each payroll class would give a more accurate projection.

**Ratio of anticipated losses to premium.

***Does not include special adjustments for 1981-82 eliminating contingency reserve, anticipating position reductions, etc.

PROCEDURE FOR DETERMINING ANNUAL GENERAL FUND APPROPRIATION

Office of Management and Budget

Positions added to or deleted from the base staffing require that the allocation for workers' compensation be adjusted, following the procedure detailed below:

Personal Services Addition/Deletions

1. Determine employee rate grouping associated with position(s) to be added/deleted. Multiply personal services (including all premium, PUST, holiday pay) by rate.
2. Apply experience modification factor and loss ratio.
3. Add/delete resulting amount to/from base allocation.

Office of Management and Budget will monitor changes in factors inherent in allocation determination and review or recompute the allocation, in conjunction with Personnel, based on revised data.

As established by the State insurance plan, 2/3 of overtime allocations are subject to workers' compensation. Therefore, overtime additions or deletions, less 1/3, should be applied to steps 2 and 3 above and appropriate adjustments made to base allocation.

Credits to the General Fund

As shown above, reserves in excess of claims will be calculated each year as a part of the Annual Budget preparation process, and the amount needed from the General Fund reduced accordingly. In the event that surplus reserves exceed the amount which would otherwise be required from the General Fund, the net surplus shall be transferred back to the General Fund as soon as possible.

Procedure for Transferring Appropriate Funds from the General Fund to the Workers' Compensation Trust Fund

In order to retain funds and interest earnings in the General Fund to the maximum degree practical, the General Fund amount appropriated for transfer to the Workers' Compensation Trust Fund shall be transferred in thirteen payments, one payment to be made every two pay periods. The amount payable will be calculated utilizing four weeks data (two pay periods) from the biweekly Workers' Compensation Payroll for each rate classification. The payroll amounts in the various rate classifications will be multiplied by State premium rates to determine an estimated premium, which is then multiplied by the current rate for experience modification as established by utilizing information obtained from the Workers' Compensation Insurance Rating Bureau. The subtotal is then reduced by 1/13 of the anticipated yearly savings giving the amount due for transfer to the Workers' Compensation Trust Fund. The following is an example of the necessary calculations (utilizing 1976-77 data).

PROCEDURE FOR DETERMINING ANNUAL GENERAL FUND APPROPRIATION

4 Week Period	Code	W/C Payroll	x	Rate	=	Premium Base
9/5/76 to 10/2/76	7706	\$ 917,800		.1352		\$ 125,004
	7720	1,252,248		.1091		136,620
	8810	1,082,518		.0032		3,464
	9410	787,680		.0232		18,274
	9420	976,738		.0768		75,013
						<u>358,376</u>
				Experience Modification		x .85
						<u>\$ 304,620</u>
				Less 1/13 of Anticipated Yearly Savings		<36,538>
				Amount Due W/C Trust Fund		<u>\$ 268,082</u>

At the end of each four week period, the Workers' Compensation Supervisor will forward to the Finance Accounting Department a request to transfer the calculated amount to the Workers' Compensation Trust Fund. Utilizing an adjustment voucher, Accounting will effect the requested transfer, and send written notification to the Workers' Compensation Supervisor that the transfer has been accomplished.

Procedural Standards for Reserving Individual Claims

All injury claims serious enough to be open six months after the date of injury shall be reviewed individually by the claims adjustor responsible for adjustment of the claim. An Estimate Evaluation Worksheet (Form #190-530) shall be used for this purpose, and a reserve for the claim shall be established in the amount of the maximum probable cost of the claim as shown on the worksheet (sample attached). Permanent disability amounts shall be computed using formulas from the State of California Permanent Disability Rating Guide. All reserve amounts for individual claims of \$100,000 or more will be reviewed by the Workers' Compensation Supervisor.

COMPENSATION BENEFITS

TEMPORARY DISABILITY BENEFITS		MINIMUM SURE	MAXIMUM PROBABLE
1. PAID TO DATE		\$ 1100	\$ 1050
2. FUTURE RATE(S) \$ 175	X WEEKS 21	\$ 4550	
RATE(S) \$ 175	X WEEKS 52		
TEMPORARY DISABILITY TOTALS		\$ 6200	\$ 9100
PERMANENT DISABILITY/DEATH BENEFITS			\$ 11750
70 35 26 (6112) = 34 12.12-30-54-33-36:2		12.12-30-54-33-36:2 12.12-30-54-33-36:2	
PERMANENT DISABILITY FORMULAS			
MINIMUM SURE		\$ 7083	
MAXIMUM PROBABLE			
REHABILITATION COSTS		\$ 11123	
MAXIMUM PROBABLE		\$ 0	
TOTAL ESTIMATED COMPENSATION		\$ 15223	\$ 31933
PAID MEDICAL		\$ 1400	\$ 1500
DOCTOR'S FEE		\$ 2000	\$ 3000
HOSPITAL		\$ 3500	\$ 5000
PHYSIO THERAPY		\$ 750	\$ 1500
DRUGS		\$ 350	\$ 500
TRANSPORTATION		\$ 150	\$ 300
NURSING CARE		\$ -	\$ -
AMPUTATED SUPPLY - LIST PROCEDURE		\$ -	\$ -
DENTAL (DENTURES, BRACES, ETC.)		\$ -	\$ -
Medical-Litigation Costs		\$ 350	\$ 500
TOTAL ESTIMATED FUTURE MEDICAL		\$ 7100	\$ 10200
IF SUBROGATION RECOVERY	TOTAL ESTIMATED MEDICAL	\$ 8500	\$ 12200
REDUCE ESTIMATE ACCORDINGLY	TOTAL CASE ESTIMATE	\$ 23753	\$ 44133

Total estimated compensation \$ _____
 Less paid temporary disability \$ _____
 Less paid permanent disability \$ _____
 Less paid rehabilitation expenses \$ _____
 Estimate of Future Compensation \$ _____
 Total estimated medical \$ _____
 Less paid medical expenses \$ _____
 Estimate of Future Medical Expenses \$ _____
 TOTAL ESTIMATE OF FUTURE COSTS \$ _____

Name Sgt. Jones
 Date 6-5-81
 Signed [Signature]
 Date 6-5-81

ESTIMATE EVALUATION WORKSHEET

CLAIM #

INJURED

COMPENSATION BENEFITS

TEMPORARY DISABILITY BENEFITS			ADJUSTER'S ESTIMATE	MAXIMUM PROBABLE
1 PAID TO DATE			\$	\$
2 FUTURE X WEEKS			\$	
RATE(S)		X WEEKS	\$	
X WEEKS			\$	
RATE(S)		X WEEKS	\$	
TEMPORARY DISABILITY TOTALS			\$	\$
PERMANENT DISABILITY DEATH BENEFITS			FACTORS OF DISABILITY	
PD RATE	AGE	OCCUPATION & GROUP #		
PERMANENT DISABILITY FORMULAS				
ADJUSTER'S ESTIMATE			\$	
MAXIMUM PROBABLE				\$
REHAB. TEMPORARY DISABILITY BENEFITS				
1. PAID TO DATE			\$	\$
2. FUTURE X WEEKS			\$	
RATE(S)		X WEEKS	\$	
X WEEKS			\$	
RATE(S)		X WEEKS	\$	
REHAB TEMPORARY DISABILITY TOTALS			\$	\$
REHAB. PROGRAM COSTS (Tuition, books, transportation, etc.)			\$	\$
VENDOR COSTS			\$	\$
TOTAL REHAB. COSTS			\$	\$
TOTAL ESTIMATED COMPENSATION			\$	\$
PAID MEDICAL			\$	\$
FUTURE MEDICAL (Include doctor fees, hospital costs, physical therapy, drugs, transportation, etc.)			\$	\$
MEDICAL - LEGAL COSTS			\$	\$
MISC. MEDICAL (Medical appliances, nursing care, etc.)			\$	\$
TOTAL ESTIMATED FUTURE MEDICAL			\$	\$
NAME: _____			TOTAL ESTIMATED MEDICAL	\$
DATE: _____			TOTAL CASE ESTIMATE	\$

CITY OF SAN JOSE—MEMORANDUM

TO Richard A. Barakatt
Budget Supervisor
SUBJECT Unfunded Liability of Workers' Compensation
Trust Fund

FROM Robert A. Parnquist
Director of Personnel
DATE March 26, 1985

APPROVED

DATE

BACKGROUND

City policy and procedures provide for a fully funded workers' compensation program. In order to carry out this fiscally sound policy, fiscal year losses are projected before actual occurrence. When actual claims are filed, reserves are set aside based on our estimate of future liability for each claim. These reserves are refined yearly as we receive more accurate information about claims cost.

PROBLEM

Because of the investment loss there will be a partially unfunded liability for workers' compensation claims occurring in the 1984-85 fiscal year. The exact amount of unfunded liability is unknown at this time.

ANALYSIS

The projected deficit is the result of the 6.3 million dollar loss charged to the Workers' Compensation Trust Fund as a result of the 60 million dollar investment loss. The deficit will be partially offset by what would have been a two million dollar surplus in claim reserves as of June 30, 1984. The unfunded liability will be further reduced if there is a favorable difference between projected losses and actual losses when evaluation of the 84-85 losses can be completed, as well as the annual re-evaluation of losses for all self-insured years, 74-75 through 83-84. This evaluation will be completed by September 1985.

The reason for the current deficit is shown below:

	<u>AS OF 6-30-84</u>
Amount in Claims Reserves Account	\$20,261,500
Reserves Required	(19,301,733)
SURPLUS RESERVES	\$ 959,767

1984-85 FY ESTIMATE


Interfund Transfer	\$ 2,480,686*
Interest Earnings	1,500,000
Temporary Disability Adjustment	500,000
Surplus as of 6-30-84	959,767
Projected Losses	(8,407,000)
Administrative Expense	<u>(552,000)</u>

CURRENT ESTIMATED DEFICIT AS OF 6-30-85 (\$3,518,547)

The projected loss figure of 8.4 million dollars for 84-85 is probably high (based on an evaluation of recent loss projections before occurrence). However, the re-evaluation of losses for previous fiscal years may be increased (or decreased) when the re-evaluation of losses for all self-insured years is completed on September 1, 1985.

RECOMMENDATION

It is recommended that the unfunded liability be more clearly defined (in September 1985) before additional appropriations be considered for the Workers' Compensation Trust Fund. However, if this recommendation is followed, it should be understood that a partially unfunded liability will exist and that the revised method used to determine the recommended interfund transfer for 1985-86 is not expected to create a surplus in the Trust Fund to offset the unfunded liability or reduce the 1986-87 appropriation to the Workers' Compensation Trust Fund.


Robert L. Farnquist
Director of Personnel

* The very low 2.4 million dollar interfund transfer request assumed a 4 million dollar surplus in workers' compensation reserves. However, 6.3 million dollars of the investment loss was charged to the Trust Fund after the interfund transfer request was determined. (By comparison, the 1983-84 interfund transfer request was 6.8 million and the 1982-83 was 6.9 million.)

CITY OF SAN JOSE—MEMORANDUM

TO Jerry Silva
City Auditor

SUBJECT Attached Budget Summary

FROM Patricia E. Sausedo
Councilmember

DATE May 22, 1985

APPROVED

P. Sausedo

DATE 5-22-85

Please see attached Budget Summary from Mr. Newfarmer. In particular, I am concerned over the overlooked adjustment in the Workers' Compensation Fund. If my memory serves me, I believe substantial adjustments have occurred in past budgets.

I would very much like you to look into the current methods of projection utilized for this Fund and report back to the Council with possible suggestions to more accurately project these dollars in the future budgetary processes.

If this request constitutes a major undertaking, please notify my office and I will agendize this request and seek Council direction.

PES:js
Attachment

cc: Mayor and City Council
Gerald Newfarmer, City Manager

RECEIVED
MAY 28 1985

IV-1

CITY AUDITOR

II-20